

FISCAL NOTE

SB 667 - HB 770

March 15, 2007

SUMMARY OF BILL: Enacts the “Food Tax – Adult Materials Tax Swap Act of 2007”, effective July 1, 2007. Reduces the state sales tax rate on food and food ingredients from 6% to 3%. Levies a 25% sales tax on certain transactions by adult bookstores, sexually explicit businesses, escort-type businesses, and on individual charges for viewing sexually explicit movies in hotels or motels. Incrementally increases the sales tax rate on such transactions by 3% each fiscal year beginning in FY08-09, and ending in FY17-18, under specified conditions.

ESTIMATED FISCAL IMPACT:

Decrease State Revenues – Net Impact

\$56,455,000 / General Fund
\$126,620,000 / Education Fund
\$11,223,000 / Earmarked to Local Governments
\$715,000 / Department of Revenue
\$1,787,000 / Sinking Fund

Increase State Expenditures –

\$11,223,000 Recurring (Hold harmless provision)
\$238,000 Recurring
\$162,000 One-Time

Decrease Local Govt. Revenues - \$236,000

Other Fiscal Impact – Additional decreases to state revenues estimated to be \$124,000 per year beginning in FY08-09 and continuing through FY17-18. Beginning in FY18-19, state revenues will decrease further by an estimated \$6,100,000 per year due to continued growth of taxable food sales.

Food Tax Assumptions:

- According to the Department of Revenue (DOR), taxable sales of food and food ingredients in Tennessee for FY05-06 were approximately \$7,753,600,000.

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- Based on historical collection patterns, taxable sales of food and food ingredients are estimated to grow by approximately 2.5% per year.
- Taxable sales for FY07-08 are estimated to be approximately \$8,146,126,000.
- The recurring decrease in state sales tax revenue resulting from a one-time 3% rate reduction for food sales is estimated to be \$244,384,000 ($\$8,146,126,000 \times 3\% = \$244,383,780$) per year.
- The estimated decrease of \$244,384,000 in state sales tax revenue would have been apportioned as follows: \$70,931,000 to the General Fund, \$159,087,000 to education, \$11,223,000 to local governments, \$898,000 to DOR, and \$2,245,000 to the Sinking Fund.
- The state will forgo additional sales tax revenue in subsequent fiscal years due to growth of taxable sales.
- Local governments are held harmless from the loss of state-shared sales tax revenue. As a result, the increase to state expenditures for holding the local governments harmless is estimated to be \$11,223,000 per year.
- Local option sales tax collections on food remain unchanged.

Adult Entertainment Tax Assumptions

- According to DOR, and based on several reports regarding the adult entertainment industry, gross revenues for the industry at the national level are estimated to be at least \$12.0 billion per year.
- Based on data from the U.S. Census Bureau, the population in Tennessee is estimated to be 6.04 million; the population for the U.S. is estimated to be 301.1 million.
- Tennessee makes up 2.0% of national population ($6.04 \text{ million} \div 301.1 \text{ million} = 2.01\%$).
- Tennessee accounts for 2.0% (or \$240,000,000) of the adult entertainment industry's gross revenues ($\$12.0 \text{ billion} \times 2\% = \$240,000,000$).
- According to DOR, taxable sales occurring in Tennessee require adjustment to reflect nexus-related barriers to taxing sexually-explicit internet websites and for taxing sexually-explicit phone conversations for pay. This adjustment is estimated to be a 12.5% reduction to taxable sales.
- Taxable sales adjusted for nexus-related issues are estimated to be approximately \$210,000,000 per year ($\$240,000,000 \times [100\% - 12.5\%] = \$210,000,000$).
- Given the 25% tax proposed for adult entertainment, taxable sales are estimated to decrease by an additional 5%.
- Taxable sales adjusted for a decrease in quantity demanded is estimated to be \$199.5 million per year ($\$210.0 \text{ million} \times [100\% - 5\%] = \199.5 million).
- The increase to state revenues resulting from the additional 25% tax to be levied on adult entertainment is estimated to be \$49,875,000 per year ($\$199,500,000 \times 25\% = \$49,875,000$).
- The estimated increase of \$49,875,000 would be apportioned as other sales tax revenue is currently apportioned. As a result, the apportionment of this revenue would be as follows: \$14,476,000 to the General Fund,

\$32,467,000 to the Education Fund, \$2,291,000 to local governments, \$183,000 to DOR, and \$458,000 to the Sinking Fund.

- The 5% decrease in quantity demanded will reduce local option sales tax revenue.
- The local option sales tax rate is estimated to average 2.25%.
- The decrease to local government revenues is estimated to be \$236,000 per year ($[\$210.0 \text{ million} - \$199.5 \text{ million}] \times 2.25\% = \$236,250$).

Other Assumptions

- The legislative intent of this act is that the fiscal impact of this bill be at least revenue-neutral.
- Three additional Taxpayer Services Representatives for the DOR.
- The increase to one-time and recurring state expenditures related to the three additional positions are estimated to be \$27,000 and \$238,000 respectively.
- The increase to one-time state expenditures for computer and software modifications is estimated to be \$135,000.
- Increasing the adult entertainment tax by 3% annually beginning with FY08-09 and ending with FY17-18 is expected to increase state tax collections by approximately \$5,985,000 ($\$199,500,000 \text{ taxable sales} \times 3\% \text{ increase} = \$5,985,000$). However, sales tax collections from food are expected to decrease by \$6,109,000 per year in subsequent years due to the growth of taxable food sales ($[\$8,146,126,000 \times 102.5\% \text{ growth}] - \$8,146,126,000 \times 3\% \text{ proposed rate reduction} = \$6,109,594$).
- Additional state revenue decreases are estimated to be \$124,000 per year beginning in FY08-09, and in each subsequent year through FY17-18 ($\$6,109,000 \text{ decrease} + \$5,985,000 \text{ increase} = \text{net decrease of } \$124,000$).
- Beginning in FY18-19, the additional decrease to state tax revenues resulting from growth of taxable sales on food is estimated to be \$6,100,000 per year.

CERTIFICATION:

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.



James W. White, Executive Director